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SUBJECT: SCENESETTER FOR SPECIAL ENVOY MORNINGSTAR'S VISIT
TO BRUSSELS, APRIL 22-23, 2009

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11. (SBU) Welcome to Brussels. Your visit comes as the EU struggles to develop a common energy policy, internally and externally. The Europeans view energy security in broad terms -- to include alternative sources and supply of gas, development of additional renewable resources, research into clean coal, and the construction of nuclear power plants (where politically acceptable). And overlaying the energy security debate here is the imperative that European leaders see to combat climate change. It is thus almost impossible to have energy-related discussions in Brussels without addressing each of these components of energy security: internal EU market liberalization, measures to address climate change, and external energy policy.

EXTERNAL ENERGY POLICY

12. (U) About one-quarter of the EU's energy consumption is fueled by natural gas. Recent International Energy Agency (IEA) predictions suggest that gas demand will more than double by 2030, while Europe's own production - now primarily from the North Sea and Norway - is declining. Meeting demand will require significant increases in gas-imports, as well as import capacity. The IEA estimates that annual European demand could increase by about 200 billion cubic meters (bcm), or 7 trillion cubic feet, over the next two decades from 500 bcm now, while production declines from roughly 300 bcm to about 200 bcm. Today Russian gas accounts for about one-quarter of the EU's aggregate supply, while imports from Norway, Algeria, and the Caspian and Central Asian states (through Russia) comprise the remainder. The dependence on Russian gas and infrastructure, however, is much greater for many Central European countries that rely on Russia for more than 75 percent of their gas imports. This was highlighted during the latest Ukraine/Russia gas conflict. The EU will have to develop a number of new transport pipelines if it is to reduce its dependency on gas coming from and through Russia.

13. (U) The Commission and Council have proposed a more robust role for the European Union in developing an external energy policy. Javier Solana has publicly argued for more effective EU coordination on external energy issues, with strong support from the Central European states, who are most concerned about Gazprom's hegemony and Germany's close ties to Moscow. EU Energy Commissioner Piebalgs (a native of Latvia) supports this as well. The Treaty of Lisbon, rejected last year by the Irish but still under consideration, contains language intended to give the EU additional say over crafting and implementing a common external energy policy. That said, many member states remain

divided on what the policy should be, and the EU does not speak with one voice on external energy issues. Russia has excelled at exploiting these divisions, with Gazprom continuing to make inroads into European gas distribution and supply networks.

¶4. (SBU) To date, the Commission has publicly taken an open approach to new gas infrastructure projects. While supporting the Nabucco and Turkey-Greece-Italy Interconnector (TGI) pipeline projects they have also supported the Russian Nord Stream and South Stream projects, even though South Stream, which would bypass Turkey under the Black Sea, would compete with Nabucco and TGI for supply. Privately, Commission officials have indicated they prefer the non-Russian solutions but view South Stream as a convenient bargaining tool in transit negotiations with Turkey.

¶5. (SBU) A large part of the Commission's efforts to advance the Southern Corridor have been focused on Turkey, attempting to reach a transit agreement that would be feasible for European buyers and Caspian producers and allay Turkey's security of supply concerns. The efforts have intensified in the wake of the Russian gas cutoff with the emphasis increasingly on Nabucco. The major obstacle has been Turkey's concerns over its own natural gas needs -- Turkey is looking for as much as 8 bcm of gas from Azerbaijan for its own use, which would effectively sop up the potential supplies from Azerbaijan's Shah Deniz II project leaving insufficient gas to source TGI and/or Nabucco. In addition, Turkey has declared the opening of the Energy Chapter on accession a key component to the talks. On this issue, there is near unanimity with Cyprus being the lone opponent.

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¶6. (SBU) The U.S. has been supportive of the EU's efforts to open up the Southern Corridor. U.S. officials have held numerous discussions with the Europeans, Turkey, and representatives from producer and consumer states with the aim of encouraging them to find a middle ground that will allow the gas to flow. From the U.S. standpoint, opening the Southern Corridor is a win, win, win scenario: it would provide greater independence for the Caspian States, enhance Turkey's ties with the West, and strengthen Europe's energy security. However, with respect to Nabucco, gas companies such as the German RWE and Austrian OMV have stated that Azeri gas will not alone make the project commercially viable. They are therefore exploring other options, including gas from Iraq, Russia, and Iran, as well as transiting Turkmen gas through Iran. We have urged senior EU officials to increase engagement with Turkmen officials to demonstrate firm interest in Turkmen supplies.

RECOVERY PACKAGE

¶7. (U) The EU Parliament and the Czech EU Presidency reached a tentative agreement on April 16 on a package to boost Europe's economy. The 3.98-billion-euro (5.3-billion-U.S. dollar), EU-funded package is intended to benefit cross-border projects in gas and electricity infrastructure, offshore wind energy generation and carbon capture and storage. The plan is part of EU attempts to bolster itself against energy shocks and follows this winter's gas crisis, caused by a price row between Moscow and transit country Ukraine. The "informal compromise" between the Parliament's Industry Committee and the Czech EU Presidency still needs the blessing of the full Parliament and European Council. EU Member States have been wrangling for months over what projects should benefit from the funds, which are the main EU-financed component of the bloc's 200 billion euro economic recovery plan.

¶8. (U) Projects eligible for funds under the package include the Nabucco (200 million euros) and TGI (100 million euros) gas pipelines. Another 275 million euros is to go towards linking the electricity grids of Finland and Sweden to those in Latvia, Lithuania and Estonia, which remain largely cut

off from EU power markets and dependent on Russian energy. Rounding out the list are a number of projects to connect the gas and electricity grids, principally in Eastern Europe as well as funding for Carbon Capture and Storage and Offshore Wind projects. Some Parliamentarians criticized the plan after later drafts left out funding for energy efficiency projects but an April 16 compromise seems to have addressed Parliament's concerns. Under the deal, those funds which have not been committed by the end of 2010 will be used for funding energy efficiency and renewable energy measures.

INTERNAL MARKET - THIRD ENERGY PACKAGE

¶9. (U) New energy sector liberalization proposals under consideration in the EU could have an important role in facilitating distribution of gas from the East, whether from Russia or the Caspian region. The Commission's legislative package of two draft directives and three draft regulations proposed in September 2007 are designed to ensure greater competition and third party access by effectively separating supply/production of electricity and gas from transmission networks.

¶10. (SBU) Two key aims of the internal market reforms are to increase competition and to interconnect the member states' electricity and gas grids. The potential gas grid interconnections could play an important role in enhancing European energy flexibility and security. For many of the countries of Central Europe the gas pipelines run one way - East to West - leaving these countries heavily dependent on Russia for their energy needs. Currently, if these Russian gas supplies are disrupted, there exists no infrastructure to bring in alternative supplies, as is the case in Bulgaria. Building interconnections among these member states, however, would allow for gas to be rerouted from one member state to another in such an emergency.

¶11. (U) The Commission's proposals initially called for "full ownership unbundling" in the energy sector. However, a blocking minority of six countries in the Council (led by France and Germany) opposed forcing large energy producers to give up ownership of their distribution networks and proposed

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the so-called Third Option, which allows the continued existence of vertically integrated energy companies, but at the same time lays down strict conditions to ensure that transmission system operators do not discriminate against new market entrants.

¶12. (SBU) The final version of the third energy package agreed to between Parliament and Council contains three equivalent options for the ownership separation of production and transmission activities of gas and electricity companies.

The first option implies strict ownership separation of energy production and the transmission system. The second option presumes the setting up of an independent system operator (ISO), to operate as an ownership unbundled operator securing energy transmission on another party's assets. The third option provides for legal separation of the transmission system and energy production by setting up an independent transmission operator (ITO).

¶13. (SBU) Comment. The text agreed to by the Parliament and Council preserves the carefully structured compromise among Member States over ownership unbundling. In exchange, the Parliament won increase consumer protections. Given the wide flexibility on unbundling allowed under the plan, it is uncertain whether the package, when implemented, will actually accomplish the goal of encouraging more competition and building interconnections between member states. End Comment.

SECOND STRATEGIC ENERGY REVIEW

¶14. (SBU) Last November EU Energy Commissioner Andris Piebalgs presented the Commission's 2nd Strategic Energy Review (SER) to the Parliament. The SER focuses on security

of supply and is intended by the Commission to complete the picture in developing a new "Energy Policy for Europe". The first SER concentrated on climate change, introducing the 20-20-20 targets, leading to the proposed new Renewables Directive and the revision of the Emissions Trading Scheme Directive, as well as the 3rd Energy Package. The 2nd SER contains a wide-ranging energy package which is intended to give a new boost to energy security in Europe by:

-- Putting forward a new strategy to build up energy solidarity among Member States and a new policy on energy networks to stimulate investment in more efficient, low-carbon energy networks.

-- Proposing an Energy Security and Solidarity Action Plan to secure sustainable energy supplies in the EU and looking at the challenges that Europe will face between 2020 and 2050.

-- Adopting a package of energy efficiency proposals aiming to make energy savings in key areas, such as reinforcing energy efficiency legislation on buildings and energy-using products.

¶15. (SBU) The SER contains a new five-point "EU Energy Security and Solidarity Action Plan," focused on: 1) Infrastructure needs and diversification of energy supplies (including interconnections and new supply corridors); 2) External energy relations; 3) Oil and gas stocks and crisis response mechanisms; 4) Energy efficiency; and 5) Making the best use of the EU's indigenous energy resources (including renewables, coal, and nuclear energy). The plan charts the policy priorities for the next Commission, due to take office in November 2009.

¶16. (SBU) In February, EU Energy Ministers broadly endorsed the SER, reaffirming their support for infrastructure projects to improve gas and electricity interconnections and promote large-scale offshore wind. Ministers also reiterated the need to create an external energy policy, with emphasis on developing cooperation with Russia, countries along the Southern Corridor and the Mediterranean region. Renewable energies, carbon capture and storage (CCS) and nuclear power were also highlighted as key to providing a more secure energy future.

CONCLUSION

¶17. (SBU) To sum up, you are coming to Brussels at a time when the EU has a heightened awareness of its energy security needs and the importance of its external energy relations. The Commission officials and Solana are frustrated by the

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continued lack of a common EU energy policy, but as member states jealously continue to guard their "energy sovereignty" it will be difficult for Brussels to play a greater role.

Murray

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